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IN THE
SUPREME COURT OF THE UNITED STATES

No. 95

HOOVER MOTOR EXPRESS CO., INC.,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT.

BRIEF OF PETITIONER

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Opinions Below

The opinion of the District Court for the Middle District of Tennessee is reported in 135 Fed. Supp. 818, and is copied in the transcript of the record beginning at page 9.

The opinion of the United States Court of Appeals for the Sixth Circuit is reported in 241 F. 2d 459, and is copied in the transcript of the record beginning at page 18.

Jurisdiction

The judgment of the United States Court of Appeals was entered on January 4, 1957. (R-20) The Petition for a Writ of Certiorari was granted June 17, 1957. (R-20) This Court is given jurisdiction by 28 U.S.C., Section 1254.

Questions Presented

1. Whether a common carrier of freight by motor vehicle may deduct as an operating expense for income tax purposes overweight fines which it has paid to the States where the violations of the State Weight laws were not wilful and the carrier took every precaution that could fairly be demanded to comply with the State Weight laws.

2. Whether a lawful business which incurs an item of expense which cannot be avoided by the exercise of ordinary and reasonable care is entitled to deduct such expense in computing its income tax even though such expense is denominated as a fine or penalty.

Statute Involved

The applicable statute is Section 23(a)(1)(A) of the Internal Revenue Code, which provides:

"In computing net income there shall be allowed as deductions . . . all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. . . ."

Statement of the Case

Since the record in this case consists only of the pleadings and the opinions of the two lower Courts, there is no controversial question of fact and the case, therefore, involves only a question of law.

Petitioner is a common carrier of freight by motor vehicle certificated by the Interstate Commerce Commission. It is authorized to and does transport freight to and from points in Georgia, Alabama, Tennessee, Kentucky, Missouri and Ohio.

All of the states through which Petitioner operates have statutes limiting the size and weight of trucks. These

statutes vary in some respects, but all fix maximum weight for each axle so that frequently a vehicle is within the maximum allowance for the entire vehicle but, at the time of weighing by representatives of a state, one axle is carrying too much of the overall weight so that an axle violation results. As found by the Courts in this case, this situation usually results from some shifting of cargo during transit.

On September 10, 1942 the Commissioner of Internal Revenue by express ruling held that overweight fines paid by motor carriers were deductible under Section 23 of the Revenue Act above quoted. A subsequent ruling by a different Commissioner was issued effective November 30, 1950, which reversed the prior ruling.

Upon audit of Petitioner's tax returns for the taxable years 1951-1953, inclusive, fines paid during those years were disallowed as a deductible expense and additional tax and interest was assessed against Petitioner based upon such disallowance. Petitioner paid the tax and interest and filed claims for refund, which were denied, and thereupon Petitioner filed this suit in the District Court for the recovery of the tax and interest attributable to the disallowance of the overweight fines.

Upon the trial of the case, Petitioner offered proof to show that no violation of any of the weight laws was wilful and that it took every precaution which it could reasonably take to insure compliance with the statutes of all states.

The District Court in its opinion, which was adopted by the Court of Appeals, in denying recovery stated:

"It appears that the fines paid by the plaintiff for the taxable years resulted in large measure, probably in the *vast majority of instances*, because one or more axles of the vehicle involved carried weight in excess of the per axle limitation imposed by the various states,

although in these instances the vehicle with its load of freight was within the overall weight limitations. The proof shows that such violations usually occurred because of a shifting of the freight within the vehicle during transit."

" * * * Again assuming that it took every precaution that could fairly be demanded consistent with a practical operation of its business, and assuming further that it did not act with willful intent, the Court is of the opinion that to allow the claimed deductions from gross income for the taxable years would nevertheless frustrate the clearly defined policies of the applicable state weight limitation laws." (R-12)

The District Court denied the right of plaintiff to recover the taxes resulting from the disallowance of the overweight fines, although it did permit recovery of other items. (R-17)

The Court of Appeals affirmed the District Court and adopted the District Court's conclusions. (R-19)

In view of the fact that the lower Courts based their decisions upon the assumption that the Petitioner took every precaution that could fairly be demanded consistent with the practical operation of its business and that it did not act with willful intent, the transcript of the testimony was not printed on appeal, and the case was heard in the Court of Appeals on the legal question presented by the Court's decision.

Argument

Since Petitioner is a north-south carrier, practically all of its trucks are required to cross the States of Tennessee and Kentucky. Prior to 1953 both of these States had restrictive statutes limiting the overall weight of trucks to 42,000 lbs., and 18,000 lbs. for axle which was considerably

less than the permissible weight of any of the surrounding States, including all of the other States through which Petitioner operates. Since Petitioner's trucks were required to cross these States and since both States had much more restrictive weight limitations, a great majority of the fines paid by Petitioner were paid to the States of Tennessee and Kentucky.

In 1953 Tennessee amended its statute raising the permissible gross weight to 55,980 lbs. and also raising the per axle limit. The material portions of this statute are copied in the Appendix B to the Petition for Certiorari beginning at page 34.

In 1956 the commonwealth of Kentucky amended its applicable statute so as to increase the gross permissible weight from 42,000 lbs to 59,640 lbs. The per axle limit was also increased. Section 2 of that Act provides:

"A tolerance of not more than five percent per axle load shall be permitted before a carrier is deemed to have violated subsection (3) of this section. In no event shall the gross weight exceed 59,640 pounds."

The prior Act made no allowance whatever for any tolerance on the per axle weight limitation.

The foregoing is a clear legislative recognition that a rigid axle weight limitation is impracticable and that some shifting of weight during transit is inevitable. The entire 1956 Kentucky Act is copied in Appendix B of the Petition for Certiorari beginning at page 31.

While the fines involved were paid during the years of 1951, 1952 and 1953 and subsequent amendments to State statutes would not affect the liability for the fines imposed, however, subsequent legislative enactments are quite material to determine whether the allowance of such fines

would, as held by the two lower Courts, frustrate the purpose and effectiveness of the State public policy.

Petitioner most respectfully insists that the allowances of the fines paid as an operating expense cannot possibly frustrate the enforcement of the State statutes because—

(a) Since Petitioner took every precaution that could fairly be demanded of it and did not act with wilful intent, the allowance or disallowance cannot in any way be expected to diminish future violations because the taxpayer has done all that it could do to comply with the State statutes;

(b) One of the States has by express legislation recognized that some variation on the axles of the vehicles is inevitable, and such variation is not now a violation of the State Act, and both Tennessee and Kentucky have substantially increased the permissible gross weight and axle weight.

Another State to which petitioner paid fines, Indiana, by 1953 amendment, ~~changed the~~ so-called penal provision from fines to civil penalties (Appendix B of Petition for Certiorari, page 25). Petitioner insists that this is a clear legislative recognition that the operators of a trucking company are not criminals merely because a load of freight shifts slightly during transit.

There are a number of cases from lower Federal Courts dealing with the right to deduct, as an operating expense, fines or penalties. In this regard, the Court of Appeals for the Second Circuit in the case of *Rossman Corp. vs. Commissioner*, 175 F. 2d 711, at page 713, stated:

"The Revenue Act does not declare that penalties may not be deducted; the doctrine is a judicial gloss—and, for that matter, a gloss of the lower courts only,

save as the Supreme Court recognized it by implication in *Commissioner v. Heininger*."

In *Commissioner vs. Heininger*, 320 U.S. 467, 64 S. Ct. 249, 88 L. Ed. 171, referred to in the *Rossman* case above quoted, this Court, in recognizing this "judicial gloss", cited in footnote 8 several cases. The facts in each case involved fines or penalties which resulted from violations of statutes which were of necessity either wilful or the result of negligence.

One of the cases cited is that of *Burroughs Building Material Co. vs. Commissioner* (CCA 2d), 47 F. 2d 176. In that case the question presented involved the deductibility of fines which resulted from violations of statutes prohibiting price fixing, and these violations of necessity were wilful. While the Court held against the taxpayer, in the course of opinion it states at page 180:

"Undoubtedly expenditures which are in themselves immoral, such as bribery of public officials to secure protection of an unlawful business, would not have to be allowed in order consistently to justify a deduction of fines paid for violations of law involving no moral turpitude and practically inevitable."

In the *Rossman* case decided by the same Court (CCA 2), when presented squarely with the question, the Court held that a determination of whether the violations were wilful or negligent as opposed to the non-wilful and non-negligent was material in deciding whether fines or penalties were deductible. In so doing the Court, speaking through Chief Judge Learned Hand, in referring to the decision of this Court in the *Heininger* case, stated at page 713:

"On the other hand, it is also possible to read it (the *Heininger* case) as meaning that, whether the claimed

deduction be of legal expenses or of fines or forfeitures, its allowance depends upon the place of sanctions in the scheme of enforcement of the underlying act. We think that the second is the right reading; in short that there are "penalties" and "penalties", and that some are deductible and some are not."

"Perhaps the deduction of a fine or forfeiture after an "administrative finding of guilt," is more likely to "frustrate" the "sharply defined policies" of a statute which imposes it, than the deduction of the legal expenses of an unsuccessful defense—though that seems questionable—but *certainly there is no more ground for taking as "a rigid criterion" the imposition of the fine than the incurring of the expense.* Each may "frustrate the sharply defined policies" of a statute; that will depend upon how one views their deterrent effect. *We hold therefore that in every case the question must be decided ad hoc.*" (Emphasis added)

"One may indeed argue, as the Commissioner does, that the more inspiring and relentless was the pursuit of offenders, however innocent they may have been of any wilful violation of the regulations, the more solicitous would they become to comply, and the more effective would be the enforcement of the Act. That has been a school of penology since the time of Draco; but it has not been the only school; and, as we read Commissioner v. Heininger, supra, the Supreme Court did not accept it."

The Court also recognized the importance of proper care in endeavoring to comply with the statute involved and at least inferred that before the allowance of the deduction could "frustrate" the Act there must be a finding of lack of due care. In this respect the Court stated (page 714):

"On the other hand, lack of proper care would be relevant to * * * whether the allowance would "frustrate" the Act."

This Court judicially knows that the Interstate Commerce Commission regulates the rates which common carriers may charge for their services, and all expenses of transportation are material in determining proper charges. It is, therefore, most important to the proper regulation of rates of motor carriers for the Interstate Commerce Commission, as well as carriers, to have this Court rule expressly on the questions squarely presented in this case. If States impose unavoidable costs to carriers and elect to denominate such costs as fines when, from a practical standpoint the payments are clearly remedial, the entire earnings of a common carrier can be completely absorbed by this element of expense because it has to be paid entirely from net income after taxes. This is certainly a very heavy burden to place upon a legitimate business when it is doing everything it can reasonably be expected to do to operate in a lawful manner and to perform the service for the public which it is legally obligated to perform. The allowance of the deductions in this case could not frustrate the enforcement of the applicable State statutes.

This Court has never expressly held that ordinary and necessary expenses are not deductible because the deduction may tend to frustrate sharply defined national or State policies. In the case of *Lilly vs. Commissioner*, 343 U.S. 90, 72 S. Ct. 497, this Court, in discussing the *Heintz* case, stated:

"Neither that decision nor the rule suggested by it requires disallowance of petitioners' expenditures as deductions in the instant case.

"Assuming for the sake of argument that, under some circumstances, business expenditures which are

ordinary and necessary in the generally accepted meanings of those words may not be deductible as "ordinary and necessary" expenses under 23(a)(1)(A) when they "frustrate sharply defined national or state policies proscribing particular types of conduct, supra, nevertheless the expenditures now before us do not fall in that class."

It is the insistence of Petitioner here that the ruling of the Court in the *Lilly* case is equally applicable here.

After the decision of the District Court in this case, the question was discussed in the November 29, 1955 issue of the TAX FORNIGHTER as follows:

"There are statutes which undoubtedly are so clearly penal in their character that the innocence or willfulness of the violation would not be material. That would not seem to be true if the *primary* purpose of the statute here was to prevent injury to the highway and excessive maintenance costs, rather than considerations of public safety. The purpose of the legislation should determine whether willfulness is a factor, and not whether the statute makes an express distinction between innocence and willfulness. A harsh burden should not be imposed on a legitimate business enterprise on such ambiguous grounds."

The February 29, 1957 issue stated:

"We questioned the correctness of the District Court's decision in this case, and the memorandum affirmance provides no inducement to change our view. The Courts' approach seems to us an oversimplification of the issue. For example, the District Court made no mention of the distinction between penal and remedial statutes, which was considered by the Tax Court in

Tank Truck Rentals, Inc., 26 T.C. No. 52, and the Sixth Circuit evidently saw no reason to discuss this vital question.

"It must be remembered that these cases rest on a dictum of the Supreme Court that deductions may be denied where allowance would frustrate a sharply defined policy of a state proscribing certain forms of conduct: (Cf. *Heininger*, 320 U.S. 467; *Lilly*, 343 U.S. 90.) This is implicitly vague. The law itself makes no distinction between legal and illegal expenses and it would seem that any judicial limitation must be reasonable, having regard to the nature of the prohibiting statute and of the offenses, as well as the practical side, which is supposed to be significant in taxation.

"The fact that the Supreme Court has upheld the deduction in both of the cases considered by it suggests that the issue is not one of pure black or white. The moral aspects must be balanced against the practical. The emphasis placed by the Supreme Court on competitive necessity in the *Lilly* case may be another strong clue to the correct approach."

Although the Court has consolidated this case with No. 109, *Tank Truck Rentals, Inc. vs. Commissioner*, because both cases involve the allowance or disallowance of overweight fines, the *Tank Truck* case does not involve the question here presented, that is, non-negligent and non-wilful violations.

Conclusion

Petitioner most respectfully insists that the lower Courts should be reversed and the cause remanded.

Respectfully submitted,

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